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Cases, Regulations, and Statutes

Robert P. Achenbach Jr
Iowa State University

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

BANKRUPTCY

FEDERAL TAX-*ALM* § 13.03[7].*

DISCHARGE. The U.S. Supreme Court has granted certiorari in the following case. The debtors filed their 1992 tax return on October 15, 1993 without paying the taxes. The debtors made a few small payments on the taxes but then filed for Chapter 13 in May 1996. The 1992 taxes were included in the case and the case was voluntarily dismissed in March 1997 on the same day that the debtors filed for a new Chapter 7 case. The debtors argued that the 1992 taxes were dischargeable because they were filed more than three years before the Chapter 7 bankruptcy case. The court held that the three year period in Section 523(a)(1) was tolled during the Chapter 13 case; therefore, the taxes were nondischargeable. ***In re* Young, 233 F.3d 56 (1st Cir. 2000)**.

ENVIRONMENTAL LAW

CLEAN WATER ACT. The plaintiffs claimed that the defendant's hog feeding operation violated the Clean Water Act (CWA) by applying liquid animal waste on nearby fields without obtaining a National Pollutant Discharge Elimination System (NPDES) permit. The plaintiffs alleged that the sprayed animal waste ran off the fields and into waters protected by the CWA. The defendant moved for summary judgment, arguing that the spraying of the animal wastes on the fields was separate from the hog feeding operation. The court denied summary judgment and held that the field spraying activity was an integral part of the hog feeding operation, which was a concentrated animal feeding operation subject to NPDES permit requirements. **Water Keeper Alliance v. Smithfield Foods, Inc., No. 4:01-CV-27-H(3) (E.D. N.C. Sept. 20, 2001)**.

FEDERAL AGRICULTURAL PROGRAMS

TUBERCULOSIS. The APHIS has adopted as final a regulation which splits Texas into two zones with different tuberculosis risk classifications. **65 Fed. Reg. 49271 (Sept. 27, 2001)**.

FEDERAL ESTATE AND GIFT TAX

CHARITABLE DEDUCTION. The taxpayer established a ten-year charitable lead annuity trust. The taxpayer served on the board of directors of the charitable beneficiary of the trust. The charitable organization bylaws placed the annuity income from the taxpayer's trust in a separate account and prohibited the taxpayer from voting on any aspect of the use of those funds by the charity. The IRS ruled that the transfer of stock to the trust was a completed gift and that the taxpayer had not retained any power over the annuity income. The IRS also ruled that the trust corpus would not be included in the taxpayer's estate. **Ltr. Rul. 200138018, June 25, 2001**.

TRANSFERS WITH RETAINED INTERESTS. The decedent transferred a residence to a trust for the benefit of the decedent's grandchildren. The taxpayer's daughter was named as trustee and had the power to distribute income to the beneficiaries. The beneficiaries also had the power to withdraw a maximum of any amounts contributed to the trust in a year or $10,000. The trust also provided that, at the death of the decedent, the residence was to be provided rent free to the decedent's spouse. The decedent continued to live in the residence without paying rent to the trust and paid all expenses associated with the residence. Three of the beneficiaries were minors. The court held that there was an implied agreement between the parties to the trust to allow the decedent to continue to use the residence until death; therefore, the decedent retained an interest in the residence and the fair market value of the residence was included in the decedent's estate. **Estate of Trotter v. Comm'r, T.C. Memo. 2001-250**.

VALUATION. The taxpayer contributed property to a family limited partnership in exchange for a 5 percent preferred general partnership interest and 93 percent limited partnership interest. The preferred general interest was entitled to a minimum guaranteed distribution plus 5 percent of partnership net income. The taxpayer also had the right to withdraw from the partnership with 90 days' notice and the right to terminate the partnership. The taxpayer's children owned the remaining 2 percent general partnership interests. The IRS ruled that the taxpayer's preferred general interest was an applicable retained interest and the withdrawal and termination rights were extraordinary payment rights. The IRS also ruled that the value of the applicable retained interest, the preferred general interest, had to be determined under I.R.C. § 2701 and the value was the lowest value of the guaranteed payment right, the withdrawal right or the termination right. The value of the gift to the children was to be determined using the subtraction method, subtracting the value of the preferred general partnership interest from the value of the property contributed to the partnership. **Ltr. Rul. 200138028, June 21, 2001**.

The decedent's estate include an interest in a family trust which owned timberland. The decedent's predeceased spouse had also owned an interest in the trust. The predeceased spouse's estate applied a 25 percent discount for a fractional interest and the decedent's estate discounted the decedent's interest by a 60 percent fractional interest. The estate and IRS agreed as to the fair market value of the timberland held by the trust but disagreed as to the amount of discount to be applied to the decedent's interest in the trust. The court noted that the trust management was under the control of one family member who had not managed the investment well and that the trust was formed in order to keep the land in the family. The court also noted that the decedent's and predeceased spouse's estate increased their claimed discount to 90 percent at trial. The court held that a 60 percent discount would be applied for the fractional interest, based on the opinions of the estate's experts and the history of discounts used in the area. **Estate of Baird v. Comm'r, T.C. Memo. 2001-258**.

The decedent formed a family limited partnership and contributed stock in exchange for a 98 percent limited partnership interest and a 1 percent general partnership interest. The other 1 percent was received by the decedent child. The decedent then transferred a 45 percent limited partnership interest to the child, a 15 percent interest to the child's spouse and a 38 percent interest to a trust. The main issue was the discount which would be applied to the value of the interests transferred. The court held that an aggregate 40 percent discount for lack of marketability and minority interest would be applied to each of the transferred interests. **Estate of Dailey v. Comm'r, T.C. Memo. 2001-263**.

FEDERAL INCOME TAXATION

BUSINESS EXPENSES. The taxpayer was an attorney who claimed business deductions for travel, meals and entertainment, and interest. The deductions were substantiated by a business calendar which identified the names of the clients or employees, detailed memoranda about the purpose of the meeting, and receipts and credit card statements. The court held that the taxpayer had adequately substantiated the travel and meals and entertainment expenses. The taxpayer claimed the deduction in 1995 even though the expense was incurred and paid for with the credit card in 1994. The taxpayer argued that the expense could be claimed in the tax year in which the credit card bill was paid, 1995, instead of the year in which the credit card debt was incurred, 1994, for the expense. The court held that the expense was deductible in the tax year the credit card debt for the business expense was incurred. The interest expense was paid on the credit card accounts which the taxpayer used to pay business expenses. The taxpayer argued that the interest was incurred as part of the business operation. The court held that the interest expense was an allowable business deduction to the extent the taxpayer demonstrated that the interest was actually paid. **Burton v. Comm'r, T.C. Summary Op. 2001-155**.

The decedent's estate included stock in a personal holding company. The court held that the value of the stock was to be determined based on the fair market value of its assets, which consisted mainly of timberland, after taking into account the present-value, corporate-level capital gains tax consequences, but without regard to other discounts or a beneficiary settlement agreement. A discount was allowed for potential, corporate-level capital gains because the company had a valid I.R.C. § 631 election that treated the cutting of timber each year as though it were a sale or exchange of the timber. Moreover, the court found that the most likely buyer of the stock would be a timber company or pension fund that would take into account the present-value tax consequences of built-in capital gains when arriving at the amount to pay for the company's stock. The court held that the estate was entitled to a 3 percent lack-of-marketability discount because 3 percent of the assets of the company lacked marketability. However, a nuisance discount due to the existence of a minority shareholder was not allowed in light of the desirable assets of the corporation. The appellate court reversed on the issue of the proper discount for the capital gains liability. The appellate court held that the Tax Court had followed inconsistent assumptions that, on the one hand, a buyer would continue the long-term logging of the land and that, on the other hand, the low rate of return from logging would be too low for most investors. **Est. of Jameson v. Comm'r, 2001-2 U.S. Tax Cas. (CCH) ¶ 60,420 (5th Cir. 2001),** ***rev'g and rem'g*****, T.C. Memo. 1999-43**.

C CORPORATIONS-*ALM* § 7.02[3].*

COMPENSATION. The taxpayers, husband and wife, were the sole shareholders and officers of a corporation which operated a concrete foundation business. The court held that the compensation paid to the taxpayers was unreasonable based on (1) compensation paid by similar businesses in the area and (2) the amount an independent investor in the corporation would consider reasonable in comparison to the return on the investment. **B & D Foundations, Inc. v. Comm'r, T.C. Memo. 2001-262**.

DISTRIBUTIONS. The IRS has adopted as final regulations which apply the rules of I.R.C. § 357(d), involving the treatment of liabilities assumed by a shareholder, to distributions under I.R.C. § 301. The proposed regulations provide that the amount of a distribution under Section 301 will be reduced by the amount of any liability that is treated as assumed by the distributee within the meaning of Section 357(d)(1) and (2). **66 Fed. Reg. 49279 (Sept. 27, 2001)**.

MERGER. The IRS had assessed taxes against a corporation and the assessment was upheld upon appeal to the Tax Court. The taxpayer corporation merged with that

***Agricultural Law Manual* (ALM).**

corporation and under the merger agreement, the taxpayer agreed to assume all liabilities of the corporation. The IRS then assessed the taxpayer for the taxes owed by the prior corporation. The taxpayer argued that its liability for the taxes was limited to the value of the assets acquired from the former corporation and that it was the responsibility of the IRS to prove the value of the assets. The court held that the taxpayer had agreed to assume all of the former corporation's liabilities but did not rule on the issue of whether the liability was limited to the value of the former corporation's assets because the taxpayer presented no evidence as to the value of the former corporation's assets. **Eddie Cordes, Inc. v. Comm'r, T.C. Memo. 2001-265**.

SALE OF ASSETS. The taxpayer was the sole owner of a corporation which operated a beer distributorship. The taxpayer sold the company to unrelated parties and the sales agreement contained a covenant not to compete and a consulting agreement under which the taxpayer was hired as a consultant for five years. No allocation of the sales proceeds was made for intangible assets such as good will and going concern value. The IRS argued that a portion of the amounts allocated to the covenant not to compete and the consulting agreement was actually properly allocated to the intangible assets. The court noted that much of the taxpayer's business was dependent upon the taxpayer's personal relationship with retailers and the taxpayer's personal knowledge of the area. The court also noted that the company buyers were unfamiliar with the beer distribution business in general and in the specific region supplied by the company in particular. The court assigned a portion of the sales proceeds to the covenant not to compete and the consulting agreement based on the importance of the agreements to the success of the buyers' continuation of the company's business. The court held that the remainder of the amount allocated under the sale contract to the covenant not to compete and the consulting agreement had to be allocated to the intangible assets. **Bemidji Distributing Co., Inc. v. Comm'r, T.C. Memo. 2001-260**.

COOPERATIVES. The taxpayer was a cooperative formed under a state cooperative limited liability statute which did not classify cooperative LLCs as corporations. The IRS ruled that the taxpayer was an eligible entity under Treas. Reg. § 301.7701-3 and not a per se corporation under Treas. Reg. § 301.7701-2(b)(1). **Ltr. Rul. 200139020, June 29, 2001**.

COURT AWARDS AND SETTLEMENTS-ALM § 4.02[14].* The taxpayer's employment as a regional manager of retail stores was terminated and the taxpayer brought suit against the employer for breach of contract, breach of the covenant of good faith and fair dealing, age discrimination under state law, fraud and deceit, and specific performance. The trial jury awarded damages to the taxpayer under the claim for breach of the covenant of good faith and fair dealing. The taxpayer argued that the award was excluded from gross income because one of the claims involved a tort or tort like issue. The court held that the judgment was included in the taxpayer's gross income because the award was based entirely on the contract cause of action and was not based on any tort or tortlike claim involving personal injury. The taxpayer had hired attorneys for the lawsuit under a contingency fee arrangement and the judgment award check was made out jointly to the taxpayer and the attorneys. The court held that the attorney's fees were not excluded from the taxpayer's income but could only be claimed as a miscellaneous deduction. The court followed *Benci-Woodward v. Comm'r, 219 F.3d 941 (9th Cir. 2000), affg, T.C. Memo. 1998-395* decided in the circuit to which this case is appealable. **Freeman v. Comm'r, T.C. Memo. 2001-254**.

The taxpayer was forced to resign employment by the taxpayer's employer. The taxpayer joined a class action suit against the employer which alleged age discrimination and other torts. The taxpayer signed an agreement to pay the class attorneys one-third of any recovery. A settlement was reached and the plaintiffs in the action allocated the proceeds first to litigation and administration costs. One-third of the remainder was allocated to the attorneys' fees, one-third to compensation for lost wages, and one-third for the tort injuries. The employer paid one-third of the settlement directly to the attorneys and the remainder to the class and agreed to withhold income taxes from the amount allocated to compensation for lost wages. The court held that the amount paid as attorneys' fees by the employer was included in the taxpayer's income because the liability for the fees was the responsibility of the taxpayer and not the employer. **Sinyard v. Comm'r, 2001-2 U.S. Tax Cas. (CCH) ¶. 50,645 (9th Cir. 2001), *aff'g*, T.C. Memo. 1998-364**.

The taxpayer joined a class action suit against the taxpayer's former employer under the FSLA for unpaid overtime compensation. A settlement was reached and was based on the number of hours worked by each participant in the suit. The taxpayer excluded from income the taxpayer's share of the settlement, arguing that the settlement was actually based upon a claim for infliction of emotional stress. The court noted that no claim was included in the lawsuit or the settlement allocation among the plaintiffs. The court held that the proceeds of a suit under the FSLA were included in income because the FSLA action was not a tort or tort-like action for personal injuries. In addition, the court held that no portion of the settlement could be allocated to a claim for infliction of emotional distress because that claim was not included in the lawsuit, the settlement or the calculation of the taxpayer's share of the settlement. **Ramey v. Comm'r, T.C. Summary Op. 2001-156**.

The taxpayer had purchased an automobile dealership and eventually filed suit against the manufacturer's distributor for breach of contract, violation of state and federal anti-racketeering laws, fraud, and injunctive relief. The parties reached a settlement which did not allocate any of the proceeds to any personal injury claim. The court held that the settlement proceeds were included in the taxpayer's income because the law suit did not allege any personal injuries and the settlement did not allocate any of the proceeds to compensation for personal injuries. ***In re* Jones,**

2001-2 U.S. Tax Cas. (CCH) ¶ 50,638 (Bankr. M.D. Fla. 2001).

DEPRECIATION. The taxpayers were partnerships which claimed depreciation for natural gas pipelines owned and operated by the partnerships. The partnerships' operations did not involve any production of the natural gas. The court held that under *Rev. Proc. 87-56, 1987-2 C.B. 674*, pipeline transportation was a separate business and the assets were properly classified under Class 46.0 as 15-year property for depreciation purposes. **Saginaw Bay Pipeline Co. v. United States, 2001-2 U.S. Tax Cas. (CCH) ¶ 50,642 (E.D. Mich. 2001)**.

DISASTER LOSSES. The IRS is reminding taxpayers who have suffered property losses due to the September 11, 2001 terrorist attacks that they may get a quick tax refund by claiming such losses on amended returns for tax year 2000. Affected taxpayers include individuals and businesses in presidentially-declared disaster areas. By amending tax year 2000 returns, taxpayers may receive refunds in a few weeks rather than after the filing of a 2001 return. Taxpayers that were granted extensions to file tax year 2000 returns may include disaster losses on such returns. **IR-2001-87**. In addition, the IRS reminded corporate taxpayers that they may claim a quick refund of estimated tax overpayments before they even file their tax return. This could help fiscal year filers whose expected profits were reduced or eliminated by the September 11 terrorist attacks or by other conditions. The proper form is Form 4466, "Corporation Application for Quick Refund of Overpayment of Estimated Tax." **IR-2001-90**.

DISCHARGE OF INDEBTEDNESS. The taxpayer was employed as a real estate agent in an agency company. The taxpayer had financial difficulties and the employer agreed to purchase the taxpayer's house and rent it back to the taxpayer. The taxpayer failed to make all rent payments. The taxpayer made a sale of real estate and the employer withheld a portion of the commission due to the taxpayer equal to the amount owed for the rent. The taxpayer argued that the amount withheld by the employer was not income because the taxpayer disputed the amount owed. The court found that the amount was not in dispute because the taxpayer did not pursue the matter. The court held that the entire commission was income to the taxpayer. **Velasco v. Comm'r, T.C. Memo. 2001-252**.

EMPLOYEE EXPENSES. The IRS has issued revenue procedures updating *Rev. Proc. 2000-39, I.R.B. 2000-41, 340*, which provide rules under which the amount of ordinary and necessary business expenses of an employee for lodging, meals, and incidental expenses or for meals and incidental expenses incurred while traveling away from home will be deemed substantiated under Temp. Treas. Reg. § 1.274-5T when a payor (the employer, its agent, or a third party) provides a per diem allowance under a reimbursement or other expense allowance arrangement to pay for such expenses. This revenue procedure also provides an optional method for employees and self-employed individuals to use in computing the deductible costs of business meal and incidental expenses paid or incurred while traveling away from home. Use of a method described in this revenue procedure is not mandatory and a taxpayer may use actual allowable expenses if the taxpayer maintains adequate records or other sufficient evidence for proper substantiation. This revenue procedure does not provide rules under which the amount of an employee's lodging expenses will be deemed substantiated when a payor provides an allowance to pay for those expenses but not meals and incidental expenses. **Rev. Proc. 2001-47, I.R.B. 2001-__**.

HOBBY LOSSES. The taxpayer was an attorney who owned an apple and timber farm. The taxpayer planted oak and walnut trees on the timber land and expected the trees to be suitable for sale in 40 years. The court held that the farm was not operated with an intent to make a profit because (1) the taxpayer did not have a business plan for making a profit and did not keep complete records of the farm activities, (2) the taxpayer did not have any previous farming experience and did not consult experts on how to make the activity profitable, (3) the taxpayer spent a minimal amount of time on the activity, (4) the activity never produced a profit, (5) the taxpayer offset the losses against substantial income from other activities, and (6) the taxpayer used the activity primarily for recreational purposes. The court acknowledged that the oak and walnut trees would eventually have much value and potential for profit, but the court held that the mere waiting for trees to grow was not enough to make the activity a business. **Burton v. Comm'r, T.C. Summary Op. 2001-155**.

The taxpayer was an attorney and accountant and owned a 100 acre farm which the taxpayer inherited from parents. The taxpayer allowed a brother-in-law to use a portion of the land for growing hay and pasture rent free but the brother-in-law provided some maintenance of the farm. The taxpayer used the farm timberland for growing oak and walnut trees which would produce marketable wood in 30-50 years and marketable nuts in five years. The court held that the farm was not operated with the intent to make a profit because (1) the taxpayer did not have a business plan to make the farm profitable and did not keep full and accurate records, (2) the taxpayer did not have the expertise to make the farm profitable and did not seek the advice of experts, (3) the taxpayer expended significant amounts of time on the farm but did not provide evidence that this time was spent making the farm profitable, (4) although the farm appreciated in value over the period it was held by the taxpayer, the average appreciation each year did not exceed the annual losses, (5) there was no evidence that the taxpayer had contributed to the success of the farm when it was held by the parents, and (6) the farm had only losses and no source of income for three years. The other factors of Treas. Reg. § 1.183-2(b) were found to be neutral on this issue. **Mitchell v. Comm'r, T.C. Memo. 2001-269**.

The taxpayer was a medical doctor and the taxpayer and spouse started an activity which purchased, trained, showed and sold jumper horses. The activity was started primarily because the taxpayer's children were interested in riding jumper horses. The horses were maintained at third party farms and operated by employees. The activity was terminated when the child no longer participated in riding the horses. The court held that the activity was not engaged in with the intent to make a profit because (1) the taxpayers did not have a business plan for making the activity profitable; (2) the taxpayers did not have any expertise in running a profitable horse business and did not obtain the advice of experts on making the activity profitable; (3) the taxpayer failed to provide evidence of a significant amount of time spent at the activity; (4) the activity only produced losses; (5) the taxpayers had significant income from their medical practice which was partially offset by the losses; (6) the taxpayers and their children received significant amounts of person pleasure from the activity; and (7) the taxpayers carried on the activity primarily to provide riding horses for their children. The taxpayers were not assessed an accuracy-related penalty because the taxpayers reasonably relied on the advice of professionals in filing their tax returns. **Prieto v. Comm'r, T.C. Memo. 2001-266**.

IRA. The taxpayer was employed during 1997 for a month and a half with an employer who provided an employee pension plan. The taxpayer contributed $131 to the pension plan before terminating employment and accepting employment at two other companies which did not offer pension plans. The taxpayer opened an IRA during 1997, contributed $2000 to the account and claimed a $2000 IRA deduction on the 1997 return. The taxpayer argued that the IRA deduction was allowed because the taxpayer's interest in the pension plan never vested under the rules of the plan. The court held that, under Treas. Reg. §1.219-2(b), the taxpayer was an active participant in a defined benefit plan sometime in 1997; therefore, under I.R.C. § 219(g)(1), the taxpayer was not eligible for an IRA deduction in 1997. **Held v. Comm'r, T.C. Summary Op. 2001-149**.

The taxpayer was employed during 1997 for two weeks with an employer who provided an employee pension plan. The taxpayer contributed to the pension plan before terminating employment. The taxpayer opened an IRA during 1997, contributed $2000 to the account and claimed a $2000 IRA deduction on the 1997 return. The taxpayer argued that the IRA deduction was allowed because the taxpayer's interest in the pension plan never vested under the rules of the plan. The court held that, under Treas. Reg. §1.219-2(b), the taxpayer was an active participant in a defined benefit plan sometime in 1997; therefore, under I.R.C. § 219(g)(1), the taxpayer was not eligible for an IRA deduction in 1997. **Naemi v. Comm'r, T.C. Summary Op. 2001-158**.

MEDICAL SAVINGS ACCOUNT. The IRS has announced that the Archer Medical Savings Account (MSA) pilot project will not be cut off in 2001 because the number of individuals who have established Archer MSAs on or before April 15, 2001, has not exceeded 750,000. The applicable number of MSA returns projected to be filed for 2001 is 76,035. **Ann. 2001-99, I.R.B. 2001-42**.

PARTNERSHIPS-ALM § 7.03.*

PARTNER"S DISTRIBUTIVE SHARE. In 1993, the taxpayer owned a 5 percent interest in a partnership. In 1993, the partnership exchanged some real estate for other real estate and recognized gain on the transaction. The partnership return for 1993 reported that the taxpayer's share of the gain was $61,983. The taxpayer failed to report the share of partnership gain on the taxpayer's income tax return because no actual distribution of the gain was made to the partners. The court held that the taxpayer had to report the taxpayer's share of the gain as income, whether distributed or not. **Chama v. Comm'r, T.C. Memo. 2001-253**.

PENSON PLANS. For plans beginning in September 2001, the weighted average is 5.77 percent with the permissible range of 5.20 to 6.06 percent (90 to 106 percent permissible range) and 5.20 to 6.35 percent (90 to 110 percent permissible range) for purposes of determining the full funding limitation under I.R.C. § 412(c)(7). **Notice 2001-58, I.R.B. 2001-39, 299**.

SOCIAL SECURITY BENEFITS. The taxpayer lived in Washington D.C. during 1997 while receiving medical treatment while the taxpayer's spouse lived in California, the couples' primary residence. The couple did not file a joint return for 1997. The court held that the taxpayer lived apart for the spouse for 1997 for purposes of I.R.C. § 86(c). The taxpayer incurred legal expenses in obtaining the social security medical benefits and some of the benefits were paid directly to the lawyers. The court held that the amounts paid to the lawyers was considered part of the benefits received by the taxpayer. **Reese v. Comm'r, T.C. Summary Op. 2001-153**.

The taxpayers, husband and wife, received social security benefits in a tax year in which they had adjusted gross income sufficiently high to include 85 percent of the social security benefits in gross income under I.R.C. § 86. The taxpayer had excluded the social security benefits from income on the basis of statements made to them by an IRS employee. The court held that the IRS was not bound by the statements of the employee as to interpretations of law; therefore, the social security benefits were included in gross income. **Clayborn v. Comm'r, T.C. Summary Op. 2001-152**.

The taxpayer received a lump sum payment of social security disability payments in 1997 for benefits which accrued in 1995 and 1996. The taxpayer excluded the payment from income, arguing that the payment was a disability payment. The court held that social security disability payments are included in income under I.R.C. § 86(d)(1). A portion of the payment was paid directly to the taxpayer's lawyer. The court held that the payment to the lawyer was included in the taxpayer's income and was eligible for the miscellaneous deduction as an expense incurred for the production or collection of income. **Dela Cruz v. Comm'r, T.C. Summary Op. 2001-154**.

TAX SHELTERS. The IRS has announced that I has revoked *Rev. Proc. 83-78, 1983-2 C.B. 595* and *Rev. Proc. 84-84, 1984-2 C.B. 782* which describe procedures which had been used by the IRS to identify and investigate abusive tax shelter promotions. The procedures will now be published in the IRS Manual or other guidance. **Rev. Proc. 2001-49, I.R.B. 2001-39, 300**.

The taxpayers had invested in a jojoba partnership which was audited and denied research and development expense deductions. The taxpayers were then denied a passthrough deduction for their share of those expenses. This case involved assessment of the I.R.C. § 6653(a)(1) 5 percent addition to tax for underpayment of tax for negligence. The court held that the taxpayers had unreasonably relied on the partnership promoter for information about the tax benefits of the partnership. The court noted that the taxpayers were not inexperienced investors and should have seen the need to seek expert advice about the investment. **Davis v. Comm'r, T.C. Summary Op. 2001-151**.

TRUSTS. The taxpayers, husband and wife, transferred their business assets and residence to two trusts. The trusts were held to be shams because the taxpayers carried on the businesses and used the residence as before the trusts were formed and exercised control over the trusts. **Snyder v. Comm'r, T.C. Memo. 2001-255**.

The taxpayers, husband and wife, transferred their business assets to seven trusts. Payments for services rendered by the taxpayers in these businesses, rental income, and other funds were deposited in the trusts' bank accounts which the taxpayers retained control over for personal use. The income was reported on the trusts' tax returns but were not included in the taxpayers' income tax returns. The court held that the trusts were shams and ineffective assignments of income earned personally by the taxpayers. The court also held that the case was brought by the taxpayers primarily for delay and was based on frivolous arguments; therefore, the taxpayers were assessed $25,000 in I.R.C. § 6673(a)(1) penalties. **Combs v. Comm'r, T.C. Memo. 2001-264**.